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Deloitte Alternative Lender Deal Tracker

Focussed on primary deal flow in the European mid market

Deloitte Alternative Lender Deal Tracker

Welcome to the third issue of the Deloitte Alternative Lender Deal Tracker that has now been extended to cover 33 leading alternative lenders with whom Deloitte is tracking primary mid-market deals across Europe with up to €350m of debt. The number of deals covered in this edition has increased to over 198 transactions across the past 18 months.

In this edition, we have included an alternative lender "101" guide and we provide our perspective on market developments in 2014.

We have also included the key outputs of the Deloitte Q1 2014 CFO survey that highlight the increasing confidence in the corporate boardroom.

Key highlights in this issue

- Continued strong momentum in private debt fund raising and alternative lender deal flow
- Unitranche becomes mainstream, while term loan B structures penetrate the mid-market at senior loan pricing
- 198 transactions completed by 33 alternative lenders since October 2012
- Year on year increase in deals for Q1 2014 (vs Q1 2013) of 50% in the UK and 120% for the rest of Europe
- UK remains the largest market for alternative lenders with 47% of the transactions, followed by 25% in France and 11% in Germany

In this issue

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Market update

Transformation of the European leveraged loan market

The increasing number of alternative lender transactions signals a move towards a US funding model in the mid-market. In the US, banks fund a small fraction (<20%) of the leveraged loan market, while in Europe banks are still providing the majority of leveraged loans. The transformation from a bank driven model to a fund driven model in the US started in the late '90's and took over 15 years. Given the differences across the main European jurisdictions, the pace of this transformation is likely to depend on the intricacies of local markets. Increased regulatory pressure (Basel 3), ultra low interest rates and the creation of new debt funds are the primary drivers to accelerate this transformation.

Borrower friendly conditions

Borrowers continue to experience very favourable market conditions as a ballooning amount of excess liquidity targets a relatively small number of transactions. As a result of this imbalance in the supply and demand of credit, borrowers are pushing the boundaries on leverage, equity contribution and minimising lender controls. Where 2013 was marked by the success of the unitranche product, with transactions like Trainline, Manx Telecom, The Gym Group and Inenco, we predict in 2014 an increased use of non-amortising bullet term loan B (TLB) at close to bank pricing levels in the leveraged loan market.

Emergence of the Term Loan B (TLB) product in the mid market

Is there the opportunity to replicate the senior priced bullet only term loan B structure (L+4.5%) into the smaller mid-market? Borrowers prefer the bullet structures that non-bank alternative lenders can offer, but do not necessarily want the higher leverage and associated premium pricing of a unitranche structure (L+7.5%). Banks still prefer c. 30-40% of any debt structure to be amortising; but there are indications that a number of commercial bank lenders are becoming more flexible with respect to bullet only structures. To date, only a limited number of funds have been able to provide a TLB structure at close to bank pricing, but with funds applying leverage at fund level and thereby lowering their hurdle rates, we expect this number to increase over time.

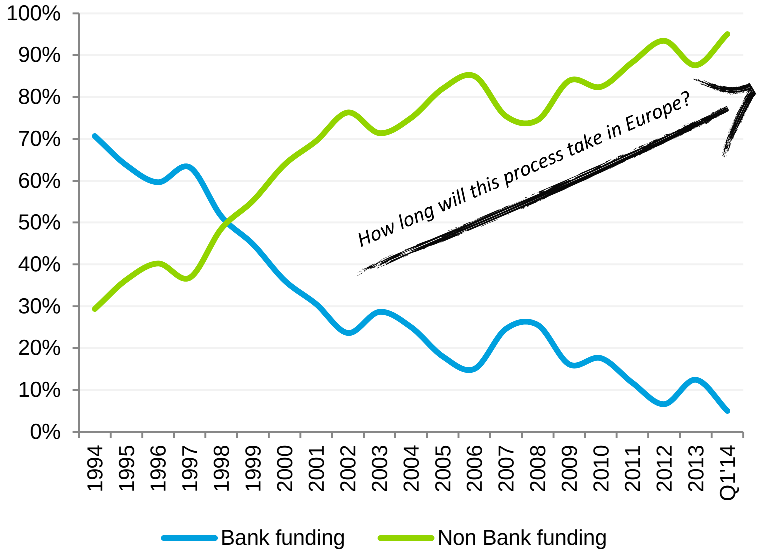
Fund raising environment for alternative lenders

We have seen a divergence in the private debt market. The mainstream funds operating at the volume end of the spectrum are increasingly competing with banks in auction processes with either a Unitranche or TLB product. Conversely, there are a large number of smaller sized private debt funds seeking complex, off-markets situations, or dipping down into the SME market where they can still secure a higher return. Undifferentiated funds, without a compelling strategy are struggling to generate deal flow. A number of managers are in the process of raising new debt funds, ranging from well known mezzanine houses that have set up dedicated private debt strategies like Crescent Capital and Park Square; private equity diversifying into private credit, like CVC and importantly, we are seeing the emergence of a number of funds specifically targeting the SME market (below £10m EBITDA), an area of the market which currently lack alternatives to bank debt. Such funds include Praesidian Capital and BMS Finance which have received £30m and £15m, respectively, from the British Business Bank. Generation IM is another fund that can service the SME market as well as larger mid market companies.

Return of the underwriting options

One of the drivers for the bullet only TLB product in the mid-market has been the return of commercial banks underwriting transactions such as the acquisition of CallCredit by GTCR and CarTrawler and BC Partners, structured with full senior leverage of around 5.0x on a bullet only TLB basis, priced at 4.50% and 4.25% over LIBOR respectively. Recent syndications have attracted significant interest from both private debt and CLO funds alike. This structure is expected to feed into the smaller mid market.

Evolution of the US leveraged debt market



Alternative lender outlook

Based on our analysis, we predict a number of key European market developments that will occur during the course of 2014, specifically:

- The number of alternative lender transactions will continue to increase
- More debt funds will be able to attract leverage at fund level
- The hold size of loans by funds will continue to increase
- Increase in senior priced TLB product in the mid-market
- More funds targeting the smaller end of the mid-market
- Increased deal origination in the European market
- Stronger collaboration between banks and alternative lenders
- A number of larger funds being able to provide an underwritten option
- Continued inflow of US liquidity

Alternative lender "101" guide

Who are the alternative lenders and why are they becoming more relevant?

Alternative lenders consist of a wide range of non-bank institutions with different strategies including private debt, mezzanine, opportunity and distressed debt.

These institutions range from larger asset managers diversifying into alternative debt to smaller funds newly set up by ex-investment professionals. Most of the funds have structures comparable to those seen in the private equity industry with a 3-5 year investment period and a 10 year life with extensions options. The limited partners in the debt funds are typically insurance, pension, private wealth, banks or sovereign wealth funds.

Over the last two years a significant number of new funds have been raised in Europe. Increased supply of alternative lender capital has helped to increase the flexibility and optionality for borrowers.

Key differences to bank lenders?

- Access to non amortising, bullet structures
- Ability to provide more structural flexibility (covenants, headroom, cash sweep, dividends, portability, etc)
- Access to debt across the capital structure via senior, second lien, unitranche, mezzanine and quasi equity
- Increased speed of execution, short credit processes and access to decision makers
- Potentially larger hold sizes for leveraged loans (€30m up to €200m)
- Deal teams of funds will continue to monitor the asset over the life of the loan

However,

- Funds are not able to provide clearing facilities and ancillaries
- Funds will target a higher yield for the increased flexibility provided
- Untested behaviour of funds throughout the cycle

What type of alternative lenders are active in the European mid market?

Type of fund	Type of loans	Typical yield requirement	Number of funds targeting the European mid market
Leveraged private debt funds	Senior / Unitranche loans	Below L + 7.0%	< 10
Unlevered private debt funds	Senior / Unitranche loans	Above L + 7.0%	> 40
Mezzanine funds	Subordinated loans	Coupon of 10% -15%	> 30
Quasi equity funds	Senior and subordinated loans	Target IRR of 15% -20%	> 30
Special situations / distressed funds	Senior and subordinated loans	Target IRR of 10% -20%	> 30
Hedge funds	Senior and subordinated loans	Varies with risk profile	> 40

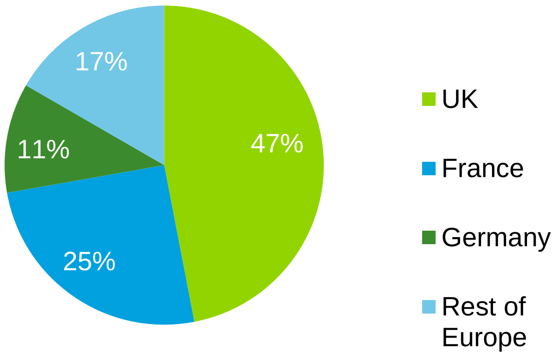
Three key questions to ask when dealing with alternative lenders:

1. *"What type of fund am I dealing with and what strategy do they employ?"*
2. *"What is the track record, sustainability of the platform, and reputation of the fund and the individuals working within the fund?"*
3. *"What is the current stage of the fund's lifecycle?"*

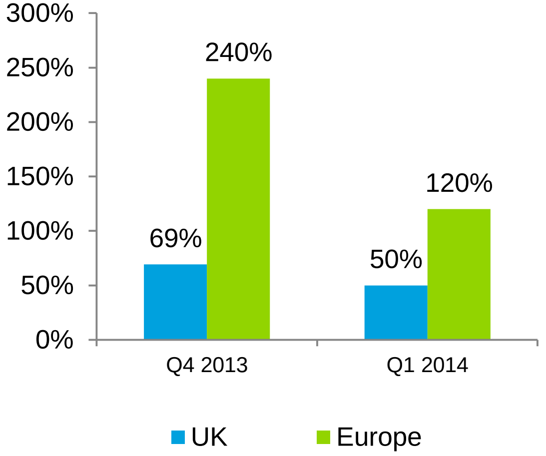
Alternative lenders increasingly targeting deals in Western Europe

- UK, France and Germany cover 83% of the deal flow.
- 47% of the transactions were in the UK, 25% in France and 11% in Germany.
- Out of the 33 lenders surveyed only 3 lenders have not completed a deal and a further 3 lenders have not completed deals outside of the UK.
- Unitranche product (45% of deals) is more popular in UK, while on the continent the senior product (37%) is dominant.
- In the UK 43% of transactions were related to LBO financing, compared to 38% in Europe.
- 11% of deals in Europe relate to bolt on M&A compared to 4% in the UK.

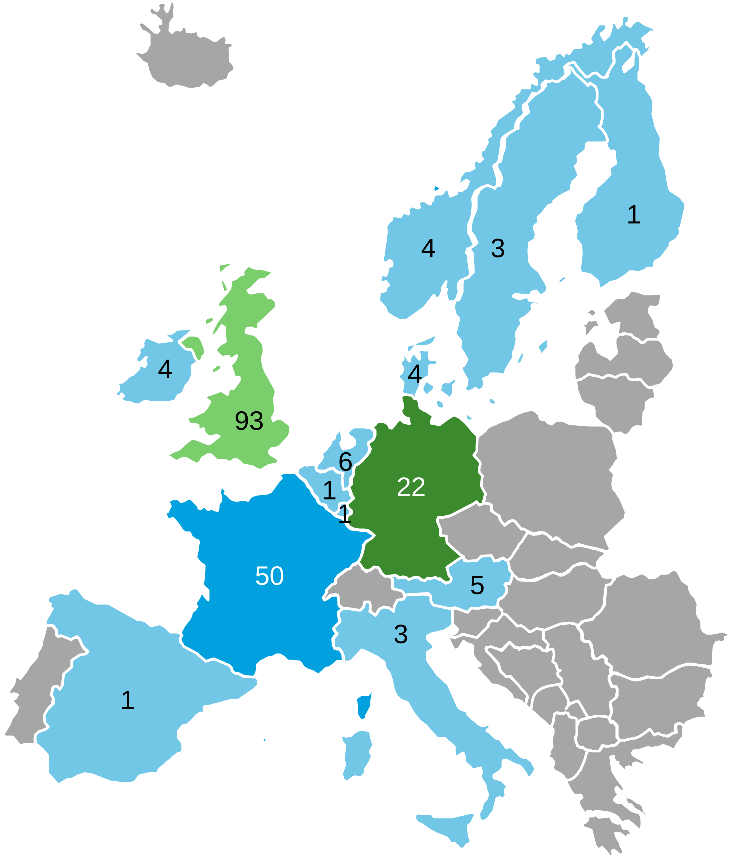
Deal volume main geographies



Year on year % increase in deal volume



Deal volume main geographies

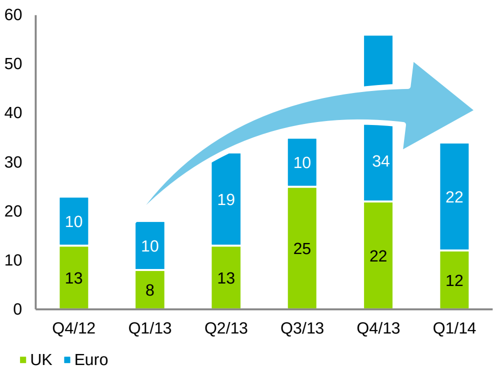


Alternative lenders continue to increase their deal flow…

Alternative Lender Deal Tracker

- Covers 33 leading alternative lenders, who have participated in 93 UK and 105 European mid market deals in the last 6 quarters.
- Only primary mid market UK and European deals with debt up to £300m or €350m are included in the survey.
- Q4 2013 had the highest deal flow with 56 deals, as borrowers were keen to complete transactions before the year end. As a result there is a slight drop of deals done in Q1 2014, similar to Q1 2013.

Number of deals completed

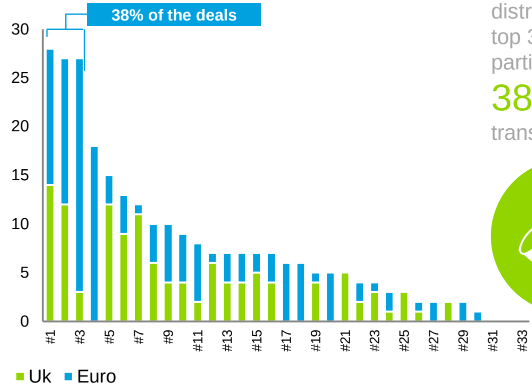


89%
increase in deal flow Q1'14 compared to Q1'13

Survey participants

- The most active alternative lender participated in 28 transactions.
- The top 3 lenders by deal flow have participated in 38% of the transactions included in our survey.
- Only 27% of transactions involved multiple alternative lenders.
- 24% of the participating funds have completed 2 or less transactions in the last 6 quarters.

Number of completed per lender



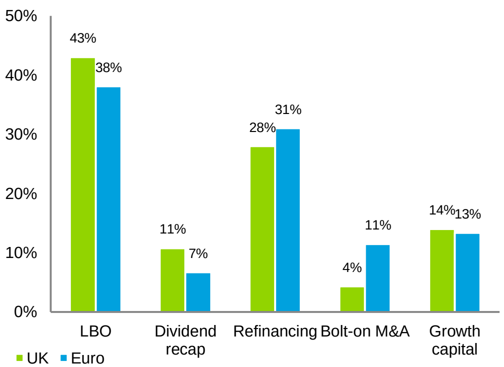
Uneven distribution with top 3 funds participating in 38% of the transactions.

…providing bespoke structures for mainly "event financing" situations

Deal purpose

- The majority of the deals are LBO related, with 43% of UK and 38% of Euro deals being used to fund a buy out.
- 28% of UK and 31% of Euro deals surveyed related to refinancing, while only 11% of UK and 7% of Euro related to a divided recap.
- Of the 198 deals, 39 deals did not involve a private equity sponsor.

Deal purpose overview

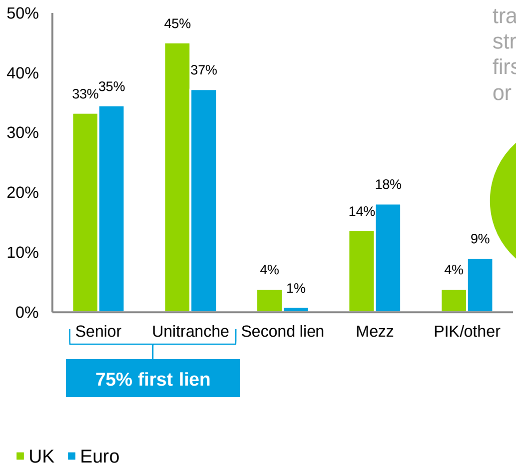


48% of the transactions involve M&A.

Structures

- "Unitranche" is the dominant structure, with (45% of UK and 37% of Euro) of the transactions classified as a Unitranche structure.
- Alternative lenders are mainly competing with banks, as 75% of the transactions are structured as a first lien structure (Senior / Unitranche).
- Subordinated structures represent only 25% of the transactions.
- The mezzanine product is more popular outside UK.
- Second lien volume remained low.

Deal structure overview



* For the purpose of the deal tracker, we classify senior only deals with pricing L + 650bps or above as Unitranche. Pricing below this hurdle is classified as senior debt

75% of the transactions are structured as first lien Senior or Unitranche.

Results from Deloitte's CFO survey, Q1 2014

Great optimism

CFO optimism has edged slightly lower this quarter but remains close to its highest level in four years.

Chart 1. Business confidence

Net % of CFOs who are more optimistic about the financial prospects for their company now than three months ago

This is reflected in CFOs' perceptions of uncertainty which have continued to fall.

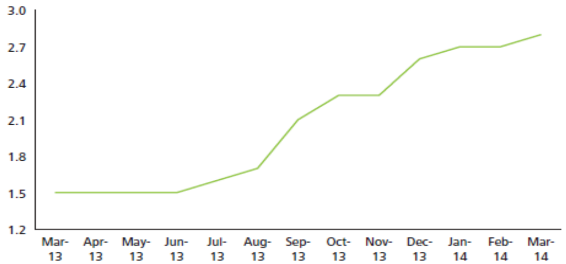
52% of CFOs rate the level of economic and financial uncertainty facing their businesses as above normal, high or very high, down from 77% a year ago.

Chart 2. Uncertainty

% of CFOs who rate the level of external financial and economic uncertainty facing their business as above normal, high or very high

Economists have become increasingly optimistic about the UK's growth prospects. Among major advanced economies, the UK has seen the biggest upgrade to 2014 growth forecasts.

Chart 3. Evolution of 2014 consensus growth forecasts for UK (%YoY)

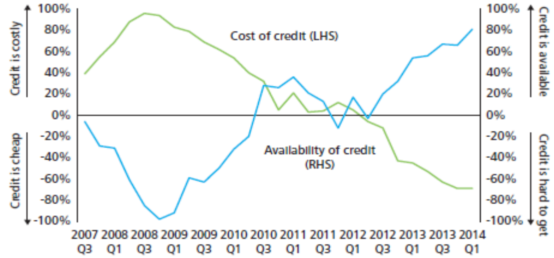


Easy credit

Financing conditions have continued to improve for the large corporates on our survey panel.

CFOs report credit is being cheaper and more easily available than at any time in the last six-and-a-half years.

Chart 4. Cost and availability of credit

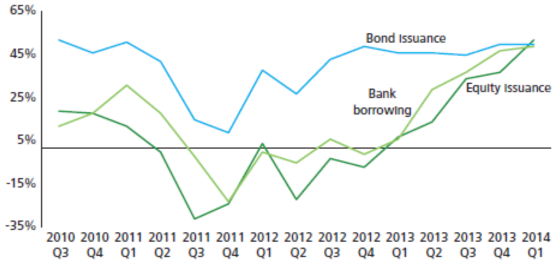


Net % of CFOs reporting credit is costly and credit is easily available

This, along with easy financing conditions, has led to a share rise in CFO expectations of bank borrowing by UK corporates over the last year.

CFOs are also very positive on increased equity issuance. For the first time in three years, a greater proportion of panellists expect equity issuance to rise in the next 12 months than those expecting a rise in bond issuance or bank borrowing.

Chart 5. Favoured source of corporate funding



Net % of CFOs reporting the following sources of funding as attractive

The balance of opinion among CFOs is that UK corporate balance sheets are underleveraged.

Chart 6. Attitudes to leverage

Net % of CFOs who think UK corporate balance sheets are overleveraged

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Recent Debt Advisory Credentials

2014 UK deals

Client	Transaction	Date	Amount
Inflexion	Refinancing	April 2014	£45m
HgCapital	Refinancing	April 2014	$63m
Bridgepoint	Refinancing	March 2014	£305m
Exponent	Acquisition financing	February 2014	£NDm
HgCapital	Refinancing	February 2014	£260m
McColl's Retail Group	IPO facility	February 2014	£85m
HgCapital	Refinancing	February 2014	£150m
HgCapital	IPO facility	February 2014	£80m
Cape Plc	Refinancing	February 2014	£295m
Shanks Group	Refinancing & retail bond	February 2014	€280m
Alternative Networks	Acquisition financing	January 2014	€43m
xchanging	Refinancing	January 2014	£125m
Mears Group	Refinancing	January 2014	£120m
Camden Lock	Real Estate Refinancing	January 2014	£230m

International

Client	Transaction	Country	Amount
GEMS Education	Refinancing	U.A.E	$545m
Novartis	Debt financing	Brazil	$354m
Tanga Cement	Growth debt capital	Tanzania	$161m
Cone Artu	DFI financing	Chile	R$270m
ENVIEM/Gulf	Refinancing	Netherlands	€200m
Autogrill/WDF	Spin-off and Refinancing	Italy	€1.25bn
Garda World Security	Refinance & HY bond	Canada	C$700m

Extensive experience across a range of industries and debt structures

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